

Internal Revenue Service

Number: **201106002**

Release Date: 2/11/2011

Index Number: 1362.01-03, 1362.02-00,
1362.02-02, 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:

CC:PSI:1

PLR-118502-10

Date:

October 19, 2010

LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Trust 1 =

Trust 2 =

Dear :

This responds to a letter dated March 8, 2010, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1. X elected to be an S corporation effective Date 2. On Date 3, Trust 1

and Trust 2 became shareholders of X. Trust 1 intended to be treated as an Electing Small Business Trust (ESBT) as of Date 3, but Trust 1 did not file a timely ESBT election. The current income beneficiary of Trust 2 intended for Trust 2 to be a Qualified Subchapter S Trust (QSST) as of Date 3, but failed to make an election to treat Trust 2 as a QSST. Consequently, X's S corporation election terminated on Date 3.

X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the QSST which consists of S corporation stock to which an election under § 1361(d)(2) applies. Section 1361(d)(2) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S Corporation.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of cessation. § 1362(d)(2)(B).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 as a result of the transfer of X shares to Trust 1 and Trust 2 and that the termination was inadvertent within the meaning of § 1362(f).

We further conclude that, pursuant to § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, assuming X's S corporation election is valid and not otherwise terminated under § 1362(d). Trust 1 will be treated as an ESBT, effective Date 3, provided that the trustee files an ESBT election with the appropriate service center within 60 days of the date of this letter. Trust 2 will be treated as a

QSST, effective Date 3, provided the current income beneficiary of Trust 2 elects to treat Trust 2 as a QSST, effective Date 3, with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT and QSST elections. If these conditions are not met, then this ruling is null and void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including whether X was otherwise a valid S corporation or whether Trust 1 is otherwise a valid ESBT or Trust 2 is otherwise a valid QSST.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Two copies of this letter
Copy for § 6110 purposes

cc: